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# In the Supreme Court of the United States

OCTOBER TERM, 1944

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No. 581

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

COURT HOLDING COMPANY

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*PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT*

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The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Fifth Circuit, entered in the above case on July 11, 1944, reversing the decision of the Tax Court of the United States.

## OPINIONS BELOW

The opinion of the Tax Court (R. 86-102) is reported in 2 T. C. 531. The opinion of the circuit court of appeals (R. 117-122) is reported in 143 F. 2d 823.

## JURISDICTION

The judgment of the circuit court of appeals was entered on July 11, 1944 (R. 123). The

jurisdiction of this court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

#### QUESTION PRESENTED

Whether the Tax Court committed reversible error in holding that a sale, formally made by the corporate taxpayer's two shareholders, was, in substance, a sale by the taxpayer the gain from which was attributable to it.

#### STATUTE AND REGULATIONS INVOLVED

##### Internal Revenue Code:

##### SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.  
\* \* \* (26 U. S. C. 22).

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.22 (a)-19. *Sale of capital assets by corporation.*—If property is acquired and later sold for an amount in excess of

the cost or other basis, the gain on the sale is income. If, then, a corporation sells its capital assets in whole or in part, it shall include in its gross income for the year in which the sale was made the gain from such sale, computed as provided in sections 111 to 113, inclusive. If the purchaser takes over all the assets and assumes the liabilities, the amount so assumed is part of the selling price.

\* \* \* \* \*

SEC. 19.22 (a)-21. *Gross income of corporation in liquidation.*—When a corporation is dissolved, its affairs are usually wound up by a receiver or trustees in dissolution. The corporate existence is continued for the purpose of liquidating the assets and paying the debts, and such receiver or trustees stand in the stead of the corporation for such purposes. (See sections 274 and 298.) Any sales of property by them are to be treated as if made by the corporation for the purpose of ascertaining the gain or loss. No gain or loss is realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation, however they may have appreciated or depreciated in value since their acquisition. But see section 44 (d) and section 19.44-5. (See further section 19.52-2.)

#### STATEMENT

The facts as found by the Tax Court (R. 87-93) may be summarized as follows:

Taxpayer, a Florida corporation, was organized in 1934 to acquire title, at a foreclosure sale, to an apartment building in Miami Beach. This was its only asset. Of its fifty shares outstanding, forty-eight were owned by Minnie Miller and the other two by her husband, Louis Miller. In 1938, taxpayer leased the building to Aaron and Regina Feiwish for three years commencing October 1, 1938. Some time after October 1, 1939, the Feiwishes, together with a sister and brother-in-law of Mr. Feiwish, the Fines, began negotiations with Minnie Miller for the purchase of taxpayer's property. In February 1940, Louis Miller, acting as president of taxpayer, agreed to sell and the Fines agreed to purchase the property for \$54,500. The terms of sale were agreed upon, and on February 22, 1940, the parties and their attorneys met for the purpose of having the oral agreement reduced to writing and executed. The attorney for the Fines prepared a contract embodying the terms of the oral agreement, but the writing was never executed by the corporation. Either at the meeting of February 22, or within the next two days, taxpayers' attorney advised the purchaser that taxpayer could not consummate the sale, for the reason that it would result in the imposition of a large income tax (R. 87-89).

On February 23, 1940, taxpayer's attorney and accountant met with Minnie and Louis Miller, and

Harry Miller, their son (R. 84). The three Millers, constituting all of taxpayer's directors, then held a special meeting at which it was resolved that "it would be in the best interest of the corporation to have it declare a dividend payable in the assets of the corporation, in complete liquidation and surrender of all the outstanding corporate stock." Immediately thereafter, Louis and Minnie Miller, as stockholders, held a special meeting and adopted a resolution ratifying the action of the directors. On the same afternoon, subsequent to adoption of these resolutions, a deed conveying taxpayer's property to Louis and Minnie Miller jointly was executed on taxpayer's behalf by Louis Miller as president, and attested by Harry Miller as secretary. Thereafter, the attorney for the purchaser was notified of the change in title and was requested to prepare a new contract naming the Millers individually as vendors. The contract was drawn, providing for the same purchase price and embodying the same terms and conditions as had been previously agreed upon at the meeting of February 22nd, except for a correction in the amount stated to be the unpaid balance of an existing mortgage to which the sale was subject. It was executed by the Millers as vendors and by Margaret W. Fine as purchaser on February 26, 1940. The deed from taxpayer to the Millers was recorded the same day (R. 89-90).

The contract between the Millers and Mrs. Fine recited the receipt of a down payment of \$1,000; this represented a credit against the purchase price of a rent payment in that amount made by the Feiwishes to taxpayer on January 5, 1940. The balance of the purchase price, amounting to \$53,500, was payable in the amount of \$12,500, in cash, upon closing, by the assumption of an existing first and second mortgage, and the execution of a purchase money note and third mortgage. Two thousand dollars which had been deposited with taxpayer by the Feiwishes as security for performance of the lease was applied in reduction of the purchase money note and third mortgage (R. 90-91). Taxpayer has transacted no business nor owned any property since the liquidation distribution, but has not been formally dissolved (R. 91).

In its 1940 return, taxpayer reported no gain as having been realized from the sale. In her individual return for 1940, Minnie Miller reported a long-term capital gain on the exchange of her stock for taxpayer's assets, of which fifty percent was taken into account. The Commissioner determined that taxpayer realized a taxable gain on the sale and computed a deficiency accordingly (R. 91-93). The Tax Court affirmed his determination (R. 94-101). The circuit court of appeals reversed, one judge dissenting (R. 117-122).

### **SPECIFICATION OF ERRORS TO BE URGED**

The circuit court of appeals erred:

1. In substituting its view of the facts for those found by the Tax Court.
2. In holding that the Tax Court was required, as a matter of law, to find that the sale was made by taxpayer's stockholders.
3. In holding that any formally perfect liquidation distribution by a corporation must be recognized for tax purposes, even though the distribution has no reality or business substance and is admittedly resorted to solely for tax avoidance purposes.
4. In failing to apply to the facts of this case the established principle that the substance rather than the form of a transaction is determinative of its tax consequences.
5. In reversing the judgment of the Tax Court.

### **REASONS FOR GRANTING THE WRIT**

The issue in this case was succinctly stated and resolved by the Tax Court as follows (R. 96):

The facts then may be narrowed down to this: The petitioner having entered into an oral contract to sell its property, and having received payment of part of the agreed price, at the last moment, and admittedly for the sole purpose of avoiding taxes, distributed the property to its stockholders, who promptly thereupon bound themselves in writing to perform individ-

ually the act which they had theretofore agreed to perform as a corporation. Under such circumstances we think it must be said that the Millers were carrying out the agreement made by the corporation and not an agreement made by themselves individually.

In reversing the Tax Court, the circuit court of appeals rested its decision upon what appear to be two incompatible "controlling" factors (R. 119-120): (1) That taxpayer "called off" the oral agreement (on this assumption the stockholders entered into and consummated an independent agreement of their own, since a sale concededly occurred); (2) that taxpayer did not legally "bind" itself in writing and, accordingly, was "free" to declare that it would not "go forward with the sale" in its own name but could pass title to its stockholders, in the form of a liquidation distribution, for the sole purpose of enabling them to go forward upon the "same terms" in their own names. On this hypothesis, of course, the oral agreement was not abandoned; the stockholders merely consummated individually the agreement they had negotiated on behalf of the corporation and all that was "called off" was the identity of the vendor.

On either premise, the decision below is in conflict with established principles laid down by this Court and with decisions of other circuit courts of appeals.

1. Insofar as the decision below is premised on the fact that the oral agreement was abandoned, it violates the settled principle that it is the function of the Tax Court, not the circuit court of appeals, to weigh the evidence and find the facts. *Dobson v. Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231; *Wilmington Co. v. Helvering*, 316 U. S. 164. In assuming that the oral agreement was "called off", the majority of the court below substituted its own view of the facts for that of the Tax Court. For the Tax Court had concluded that the stockholders "were carrying out the agreement made by the corporation and not an agreement made by themselves individually"; that "it was always intended and understood by the parties that the sale would be made exactly as agreed by the petitioner, except for the change in identity of the vendor"; that "consummation of the oral agreement was the substantive purpose" of the ensuing liquidation distribution and substitution of the stockholders as nominal vendors (R. 96); that the stockholders acted as agents of the corporation in consummating the agreement (R. 97); and that "the sale, although in form by the stockholders, was in reality in performance of the prior agreement" (R. 101).

Again, in assuming that the corporation was "actually" liquidated (R. 120), the majority of the court below likewise substituted its own view of the facts for that of the Tax Court. For the

Tax Court concluded (R. 96-97) that the resolutions to liquidate and the liquidation distribution were not bona fide but "were formal devices to which resort was had only in the attempt to make the transaction appear to be other than what it was." And in reaching the ultimate conclusion that the sale was in fact and substance a sale by the stockholders individually, the court below replaced the inference drawn by the Tax Court with its own.

We submit that the applicable principle was stated in the dissenting opinion below (R. 122):

The determination, therefore, whether a transaction of this kind was one of a real refusal of the corporation to sell, a real liquidation, re-negotiation with the purchaser by the stockholders, or was a sham refusal and a carrying out of the original plan through the stockholders as agents, presents a field for fact finding, a field in short in which the finding of the Tax Court is controlling.

2. Insofar as the decision below is predicated on the fact that taxpayer did not execute a binding written agreement in its own name, it violates the principle, affirmed by this Court in a variety of contexts, that tax consequences flow from the substance of a transaction, not the form in which it is cast. *Gregory v. Helvering*, 293 U. S. 465; *Minnesota Tea Co. v. Helvering*, 302 U. S. 609; *Griffiths v. Commissioner*, 308 U. S.

355; *Higgins v. Smith*, 308 U. S. 473; *United States v. Joliet & Chicago R. Co.*, 315 U. S. 44; *Lucas v. Earl*, 281 U. S. 111; *United States v. Phellis*, 257 U. S. 156. In applying the maxim that the reach of the income tax law is not to be delimited by refinements of title, this Court has uniformly held that income may be realized despite an anticipatory arrangement which prevents its passage into the taxpayer's hands. *Harrison v. Schaffner*, 312 U. S. 579; *Helvering v. Horst*, 311 U. S. 112; *Helvering v. Eubank*, 311 U. S. 122; *Helvering v. Clifford*, 309 U. S. 331; *Douglas v. Willcuts*, 296 U. S. 1; *Burnet v. Leininger*, 285 U. S. 136; *Old Colony Tr. Co. v. Commissioner*, 279 U. S. 716. To hold, as did the court below, that a corporation which has orally agreed to sell its assets and has received part of the purchase price may escape tax liability on the gain resulting from the sale by conveying title to the purchaser via its controlling stockholders, exalts artifice above reality. And to consider the "controlling" fact to be that the corporation refrained from legally binding itself by a written agreement<sup>1</sup> sanctions, we believe, the

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<sup>1</sup>The rationale of the decision below would apply with equal force in a situation where, after the corporation had executed a binding sales contract, it mutually agreed with the purchaser to rescind so as to render it "free" to make a liquidation distribution to its stockholders and substitute the stockholders as nominal vendors. The purchaser's agreement could be readily secured since acquisition of good title, not the identity of the vendor, is the purchaser's only concern.

kind of formalism which this Court has consistently refused to recognize as effectual to alter tax liability.

No valid reason exists for regarding the instant transaction as immune from operation of the doctrine enunciated in the above cases, and none was suggested in the opinion below. It is not enough to point out, as did the court below (R. 120), that a taxpayer may minimize taxes by any lawful means. The boundaries of tax avoidance do not encompass resort to legal mechanisms having no legitimate business object and designed solely to disguise the substance of the challenged tax event. The crucial question which remains, and to which the majority of the court below failed to address itself, is whether the transaction under scrutiny is in fact what it appears to be in form. The statute contemplates that if a corporation sells its property it is taxable on the resultant gain. Internal Revenue Code, Section 22 (a), *supra*, p. 2; Section 19.22 (a)-19 of Treasury Regulations 103, *supra*, pp. 2-3. On the other hand, a corporation may, without incurring tax liability, distribute its assets in kind in complete or partial liquidation, though the assets have appreciated in value since their acquisition. Section 19.22 (a)-21 of Treasury Regulations 103, *supra*, p. 3. In relieving the corporation of tax liability upon a distribution in liquidation of appreciated assets, the statute

is patently aimed at a bona fide distribution; it was not intended to embrace a distribution which, though technically perfect and literally complying with the statute, is designed to cloak what is in reality a sale to a third party.

The record here unquestionably warrants the Tax Court's conclusion that what substantially occurred was a sale by taxpayer to a third party. For quite apart from taxpayer's admission that the sole purpose of the distribution in liquidation was tax avoidance, the conclusion is irresistible that the circuitous routing of the title to the purchaser via the stockholders was without reality or business substance. The corporate assets were not received by the stockholders to hold or use as their own, even temporarily, nor in proportion to their stock holdings. The stockholders took title, through a paper liquidation distribution, only to substitute themselves individually as vendors under the written contract embodying the self-same oral agreement they had negotiated and reached on behalf of their corporation. Amounts paid to the corporation as rent and as a security deposit under an outstanding lease of the property were credited against the purchase price, while the balance of the price was made payable to the stockholders. Not a single practical result was achieved by the stockholders' receiving transitory legal ownership and acting as conduit of the title which would not have been reached had the tax-

payer simply and directly carried out its oral agreement, received the entire purchase price, and distributed the proceeds to its stockholders in liquidation.

In *Higgins v. Smith*, 308 U. S. 473, and *Griffiths v. Commissioner*, 308 U. S. 355, this Court refused to permit controlling stockholders to use the corporate entity to avoid individual taxes. Although this case presents, conversely, the tax liability of the controlled corporation, the broad principles underlying the decisions in those cases are applicable here. The attendant tax disadvantages of electing to do business as a corporation, which this Court in the *Smith* case indicated must be accepted by the stockholders, 308 U. S. at 477, included the tax burdens falling upon their controlled corporation. Cf. *Moline Properties v. Commissioner*, 319 U. S. 436; *Burnet v. Commonwealth Imp. Co.*, 287 U. S. 415.

In *United States v. Joliet & Chicago R. Co.*, 315 U. S. 44, this Court held that the umbilical cord between a corporation and its stockholders is not severed merely because the corporation transfers its property under a contract which vests all rights thereunder directly in the stockholders; though the corporation has removed itself as conduit of the proceeds, the right of the stockholders remains derivative. The anticipatory arrangement there condemned is little different, in substance and from the tax viewpoint, from that em-

ployed here. That taxpayer here invoked a "straw" distribution in liquidation as part of the arrangement can hardly suffice to insulate it from ownership of the portion of the purchase price which the purchaser paid directly to the stockholders.

3. The decision below is in conflict with decisions by other circuit courts of appeals holding that where controlling stockholders of a corporation who have negotiated for the sale of corporate assets cause the corporation to transfer the assets to themselves (either by way of a "liquidation distribution" or a "sale"), and then consummate the sale individually, corporate tax liability is not foreclosed by the form of the transaction but the court will look to its substance to discover whether the sale was in fact made by the corporation. *Meurer Steel Barrel Co. v. Commissioner* (C. C. A. 3d), decided July 21, 1944 (1944 P-H, Federal Tax Service, par. 9423); *Embry Realty Co. v. Glenn*, 116 F. 2d 682 (C. C. A. 6th); *S. A. MacQueen Co. v. Commissioner*, 67 F. 2d 857 (C. C. A. 3d); *Trafford Oil & Gas Co. v. Commissioner*, 78 F. 2d 814 (C. C. A. 3d), certiorari denied, 296 U. S. 630; *Liberty Service Corp. v. Commissioner*, 77 F. 2d 94 (C. C. A. 3d); *Nace Realty Co. v. Commissioner*, 28 B. T. A. 467, affirmed *per curiam* April 13, 1935 (C. C. A. 6th). It also conflicts in principle with decisions by other circuit courts of appeals holding that where a corporation, in the

course of liquidation, transfers its property to a trustee or agent for its stockholders, who thereafter sells the property, the sale is attributable to the corporation. *Hellebush v. Commissioner*, 65 F. 2d 902 (C. C. A. 6th); *Tazewell Electric Light & Power Co. v. Strother*, 84 F. 2d 327 (C. C. A. 4th); *Northwest Utilities Securities Corp. v. Helvering*, 67 F. 2d 619 (C. C. A. 8th), certiorari denied, 291 U. S. 684; *First Nat. Bank of Greeley, Colo. v. United States*, 86 F. 2d 938 (C. C. A. 10th); *Burnet v. Lexington Ice & Coal Co.*, 62 F. 2d 906 (C. C. A. 4th). See also Section 19.22 (a)-21 of Treasury Regulations 103, *supra*, p. 3, which provides that sales made by trustees in dissolution are to be treated as if made by the corporation.

4. Resolution of the conflict is of considerable practical importance. The decision below removes a traditional field of fact finding from the province of the Tax Court by requiring it, as a matter of law, to give effect to a sham sale by the stockholders, thus disregarding the limitations on judicial review established by *Dobson v. Commissioner*, *supra*. It is broad enough to apply to both complete and partial liquidations, and affords a ready means of tax avoidance, particularly by family corporations. It is also an invitation to controlling stockholders who have reached an agreement to sell (or otherwise dispose of) corporate assets to cause the corporation to make a last moment "liquidation distribution".

of the property to themselves and to consummate the sale individually, for the single avowed purpose of escaping the corporate tax. The decision of the court below leaves the Tax Court with a confusing array of conflicting principles by which to guide itself.

**CONCLUSION**

It is respectfully submitted that this petition for a writ of certiorari be granted.

CHARLES FAHY,  
*Solicitor General.*

OCTOBER 1944.